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CORPORATE
CREDIT
UNION

MAR16'09 PM 3:02 BOARD

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March 11, 2009

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Response to Advance Notice of Proposed Rulemaking (ANPR) for Corporate Credit Unions

Dear Ms. Rupp:

Central Corporate Credit Union (CenCorp) thanks the NCUA Board for the opportunity to comment on the ANPR for Corporate Credit Unions. As background, CenCorp is a $2.3 billion institution that serves approximately 350 credit union members based primarily in Michigan. CenCorp is one of the 26 Corporates that, along with US Central Federal Credit Union, comprise the Corporate system.

Before addressing the questions raised in the ANPR, CenCorp believes it is important to keep in mind the role and certain operational considerations of CenCorp (and Corporates in general). These items are discussed in the section below, followed by the questions in the ANPR.

CenCorp's Role and Operational Considerations

CenCorp is a member-owned cooperative that only exists to serve the interests of members. Over its 70-plus year history, it has grown in size and product offerings to meet the evolving needs of members. By leveraging their collective strength in specific product lines at CenCorp, members have created efficiencies and financial returns that they would not have achieved individually.

The foundation of CenCorp's value is built around its liquidity management offerings. CenCorp's overnight (Hi-Yield) account centralizes settlement activity and pays members a competitive return, without any account/maintenance costs (such as incoming wire transfer fees). Overnight loans are automatically advanced to members' overnight accounts up to pre-approved amounts when needed. The combined overnight deposit account and borrowing package is structured so that it is easy to manage and maximizes member value. In contrast, other providers require users to maintain multiple accounts to earn higher rates, impose account fees, and take more time to manage.

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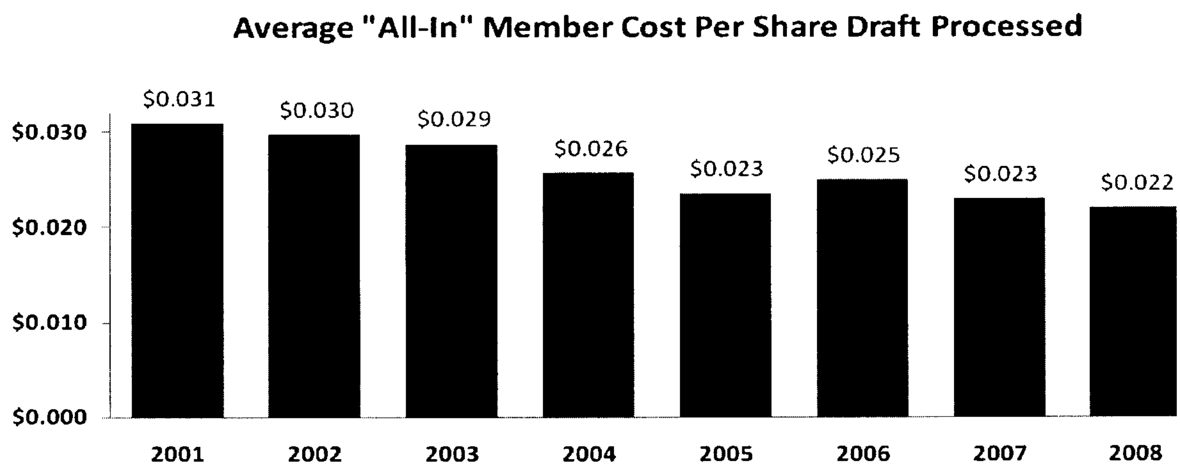
www.cencorpcu.com

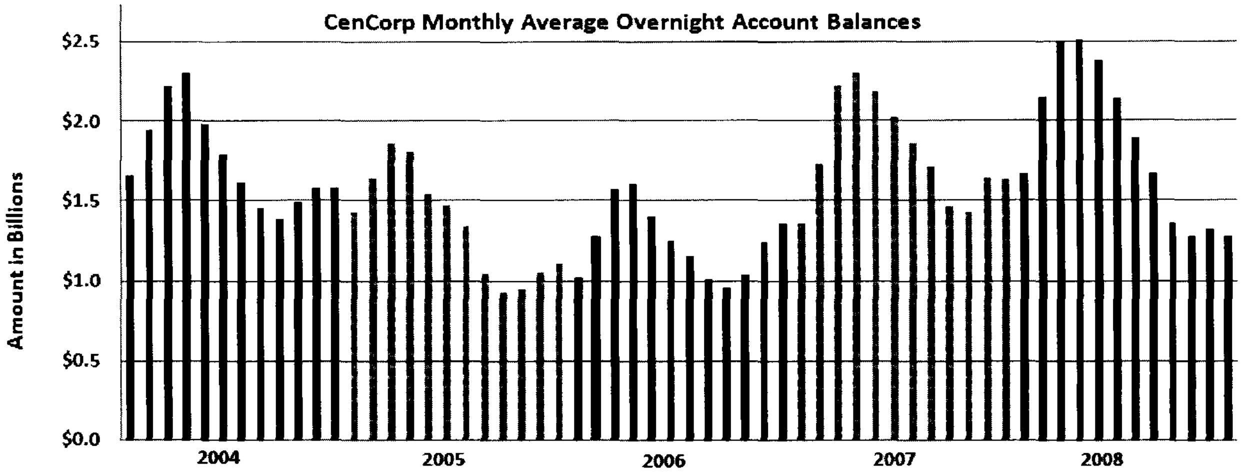
CenCorp's overnight deposit and loan rates have been competitive (CenCorp has the largest market share of overnight funds and loans for Michigan credit unions by a wide margin). The difference between what members earn on overnight deposits and pay on overnight loans is narrow. It has averaged just 25 basis points over the last five years.

CenCorp is also the largest provider of correspondent banking services, such as share draft processing, to Michigan credit unions. CenCorp acts as an aggregator of member volumes. In turn, CenCorp creates economies of scale for back-office functions or uses the collective buying power of members to negotiate more favorable pricing. The greater support of these services by members in recent years has contributed to collective price reductions, as well as patronage dividends in 2007 and 2008. As an example, the following graph demonstrates the reduction in share draft processing costs to members in recent years.



CenCorp operations are primarily built around its overnight deposit/loan package and the correspondent banking services. These are niche markets that members typically choose to "outsource" to CenCorp to generate economies of scale and returns that they would not be able to obtain individually. Term investment offerings play a secondary role. Consistent with its cooperative philosophy, CenCorp is structured to provide products and services near breakeven. Unusual events in the investment markets in 2007 and 2008 resulted in some larger than normal variances (especially higher net interest income).

CenCorp's overnight deposits are subject to fairly predictable, but volatile, seasonal fluctuations compared to other financial institutions. In many ways, CenCorp operates more like a money market mutual fund than a financial institution. The magnitude of the fluctuation in overnight deposits at CenCorp can be seen in the following graph of average monthly balances over the last five years.



CenCorp is the primary source of liquidity for members. To fulfill this role, CenCorp ensures that adequate liquidity is available during the trough of deposits that typically occurs in the third quarter of the year. As you would expect, member overnight loans peak at this same time. CenCorp historically has addressed this need by maintaining on-balance sheet liquidity and accessing external sources of liquidity (such as commercial paper).

CenCorp reinvests a substantial portion of deposits received earlier in the year in investments with short maturities so that it has available liquidity when needed by members later in the year. These short-term investments earn less than the longer term, floating rate instruments that CenCorp traditionally purchases with a portion of the deposits received from members. The lower returns on these short-term investments contribute to the narrow net interest margin that CenCorp operates with in the ordinary course of business.

Bottom line, CenCorp creates member value by harnessing their collective strength. Through their support, members receive a dual reward of (1) value-added product offerings/pricing today, and (2) strengthening an organization that is dedicated to serving them in the future.

ANPR Questions

The questions in the ANPR are organized into several sections, with multiple topics under some sections. The numbered sections that appear in the ANPR are shown in bold below. Questions on individual topics are summarized in italics. CenCorp's response follows for each topic.

1. The Role of the Corporates in the Credit Union System

Payment System. *The NCUA requested comments on ways to "isolate" payment system service risks by separating it from other businesses (legally or operationally) or establishing capital requirements specifically for payment system operations. Comments on the earnings potential of a payment systems only business were also requested.*

Payment systems at a Corporate can be roughly divided into (1) those that facilitate settlement and funds transfer activities (e.g., wire transfers) and (2) payment processing activities (e.g., share draft processing). The historical core purpose of Corporates is to provide a convenient way for credit unions to centralize their short-term funds management activities (overnight/short-term deposits or loans). The settlement and funds transfer activities are integrated in these core offerings. It would be difficult and cost prohibitive to separate these functions without destroying the value the Corporate provides.

On the other hand, the payment processing activities at certain Corporates like CenCorp are distinct operations. Corporates operate with or without these services today. These activities leverage some of CenCorp's internal infrastructure and help CenCorp provide competitive pricing on all services to members. The income earned from payment processing activities cover direct costs and makes a contribution to the "overhead" costs of the organization. The elimination of one or more of these product lines will negatively impact the overall earnings capability of CenCorp.

Separate from the short-term funds management operations, Corporates provide longer-term investment options to members. At CenCorp, term investment operations generate a narrow net interest margin (7 basis points in recent years) and operate somewhat autonomously from other parts of the organization. This line of business could be reduced or eliminated with minimal financial impact to CenCorp.

In theory, operational risk should be quantified and supported by adequate capital. The measurement of this risk has been a debated topic for financial institution regulators for years without a definitive conclusion. The Basel II capital standards for banks ultimately estimated the capital needed for operational risks based on a percentage of gross income or an acceptable internal model created by the institution (i.e., the capital needed for specific payment services wasn't defined).

CenCorp has managed its operations to fulfill member's settlement and funds transfer needs without interruption throughout its history. CenCorp's experience with payment system services is that they provide a relatively stable source of income and can be managed with little operational risk. Members find value in CenCorp's involvement, as evidenced by the fact that CenCorp has the largest market share for Michigan credit unions in the individual payment system services that it offers.

In summary, CenCorp doesn't believe that a separation of payment systems from funds management services is practical or desirable. Term investments could be reduced or eliminated with minimal impact. CenCorp believes that the businesses a Corporate delivers should be determined by members after the applicable risks have been identified and appropriately mitigated. This is best verified through the regular examination process.

Liquidity and Liquidity Management. *The NCUA requested comments on ways to preserve or strengthen a Corporate's ability to provide liquidity. This includes product limitations or cash flow duration limits.*

Corporates are subject to significant seasonal and other fluctuations in overnight member deposits. The magnitude of these fluctuations is demonstrated by the graph of CenCorp's overnight deposit balances over the last five years that was presented earlier. A Corporate needs to estimate future cash flows while incorporating a "margin of error" and/or adequate external borrowing sources.

CenCorp has developed a series of internal parameters that are based on member deposit and loan patterns, including cash flow duration limits. The initial goal of these parameters is to ensure adequate liquidity. This is especially important for Corporates such as CenCorp because providing liquidity to members is one of their primary roles. After the estimated cash flow needs are projected, CenCorp looks to invest funds in term or floating-rate investments that have higher yields. The intent is to balance the liquidity risk of investing in something other than overnight deposits and the potential to earn a positive margin on the cost of funds (similar to any financial institution).

CenCorp believes that its internal parameters are critical to liquidity management, whether they are incorporated into regulation or not. These guidelines ensure adequate liquidity is available. The NCUA has access to the specific parameters. These can be refined through examiner interaction as necessary.

Field of Membership Issues. *The NCUA notes that national fields of membership for Corporates and the resulting competition may have resulted in significant risk taking. It requests comment on narrowing the fields of membership.*

CenCorp has had a national field of membership for decades. It has concentrated its efforts on serving members in its traditional Michigan base. Our historical position has been to serve those credit unions outside this base that wish to contribute capital and actively support the organization. We do not believe that we have taken on significant additional risks in serving non-Michigan members. Conversely, we believe that competition from other Corporates has resulted in some business from Michigan members of CenCorp moving to other Corporates. CenCorp believes it would be difficult for the NCUA to disband national fields of membership at the federal level when they are available to certain state-chartered Corporates today.

CenCorp doesn't believe that a national field of membership per se is an issue. The relative common practice of a Corporate providing services to a new member *without a capital contribution* at pricing similar to what a member that has contributed capital is the bigger issue. There is a wide variation in the rate paid on member contributed capital. Some Corporates pay a lesser rate on capital accounts and yet provide services at similar pricing to both members that contribute capital and those that do not. In essence, the members that have contributed capital subsidize the non-contributing members. This practice distorts the true service pricing between members and Corporates.

National fields of membership should be allowed with a requirement that capital is contributed by all members under the same formula and return.

Expanded Investment Authority. *The existing NCUA regulations give Corporates the option to exercise additional investment authorities. The NCUA requests comments on modifying these requirements.*

The expanded investment authority provisions set forth specific requirements for Corporates to engage in investment activities beyond those available to Corporates in other sections of the regulation (Part 704). CenCorp has opted to not engage in these expanded authorities, mainly because we don't believe that the additional returns available are enough to justify the additional risks assumed (i.e., we don't believe that expanded investment authorities were cost-beneficial). CenCorp believes that regulations and the examination process as a whole should determine if investment authority and practices are appropriate. The examination process is the main tool to ensure this. The existing regulations outside of the expanded authorities section and the examination process itself should be sufficient. We don't believe the expanded investment authority section is necessary.

Structure: Two-tiered System. *The NCUA seeks comment on whether the two-tier Corporate system structure (US Central and individual Corporates) is appropriate. Further, the NCUA requests comments on powers, authorities, and capital in the future.*

The basic premise behind the two-tier Corporate structure is to centralize resources and expertise and take advantage of economies of scale. This is particularly important in the "wholesale" investment markets where Corporates typically operate and margins are narrow. There remains an advantage to member credit unions for the Corporate system to continue centralizing functions and aggregating balances.

A concern with the current structure arises when the credit risk and capital levels by the individual entities are considered. In summary, US Central assumes a disproportionately large share of the credit risk under the existing structure but has the least amount of capital. An alternative would be to move towards a structure that keeps certain resources and expertise centralized, but investment purchases occur on the individual Corporate's (as opposed to US Central's) balance sheet. US Central would provide investment credit analysis and operate in an "investment advisory" capacity. CenCorp believes that this is the appropriate direction for the Corporate system.

There would not need to be a differentiation of powers between US Central and Corporates in regulation. Revised capital requirements and investment authorities would be needed. These are addressed in later sections of this document.

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2. Corporate Capital.

Core Capital. *The NCUA requests comment on establishing a minimum "Tier One Capital" ratio. Tier One capital at Corporates currently is retained earnings and, if issued by the Corporate, certain paid-in capital. Commenters are asked to offer their view on an appropriate capital ratio, as well as a time frame to attain the capital level. Comments are requested on the related issues that impact the capital ratio, such as seasonal fluctuations in Corporate assets, retained earnings vs. contributed capital growth, and limiting services to members that contribute capital.*

The level of capital needed for a Corporate has traditionally been viewed as less than other financial institutions due to the limited risks (including credit risk) inherent at a Corporate. In retrospect, the credit risk assumed in the Corporate system was much higher than estimated. This draws into question the basis for requiring a lower level of capital vs. other financial institutions.

CenCorp believes that the Corporate capital requirement should move towards the Basel standards. These standards currently include a minimum 4% Tier One Capital ratio and minimum risk-based capital ratios. The only modifier to the Basel standards for a Corporate credit union would be to use daily average assets over the past year in the calculation of the ratios. This would accommodate for the seasonal nature of Corporate deposits. Considering the recent turmoil in the financial markets, it is anticipated that the existing Basel standards will change. This may require a further review if and when the Basel standards change.

The changes in the financial markets in the past two years have prompted CenCorp to begin reducing its asset size and increasing its capital ratio. We believe others parts of the Corporate system are doing something similar. Considering these changes are already in progress, CenCorp believes a transition period to attain revised capital requirements of one year after the new regulations would go into effect would be a reasonable transition period.

CenCorp has grown the proportion of capital that is comprised of retained earnings over time. This has been done through the retention of earnings as well as the reduction of contributed capital amounts for individual members (most recently in 2007). CenCorp believes that this trend should continue.

As noted in the field of membership section previously, CenCorp believes that Corporate services should be limited to members that contribute capital.

Membership Capital. *The NCUA requests comment on membership capital restrictions. This includes (1) changes in terms/conditions to meet the definition of "Tier Two Capital" under banking regulations, (2) the mechanics involved in adjusting member capital balances, (3) the delayed payout of downward membership capital adjustments for three years, and (4) restrictions on member withdrawals if the Corporate falls below its capital requirements.*

Consistent with the theme of moving to Basel capital standards noted previously, CenCorp believes qualifying membership capital should contain terms/conditions that meet the requirements of Tier Two Capital. Assuming the other minimum capital requirements are instituted, the adjustment of member capital balances should be a minor concern. We believe an adjustment at least annually based on a formula using a member's asset size and/or deposits at a Corporate is adequate. Assuming a Corporate meets its minimum capital requirements, we don't believe delayed payout of capital is warranted. Withdrawals should be restricted if a Corporate would fall below its capital requirement.

Risk-based Capital and Contributed Capital Requirements. *The NCUA requests comment on risk-based capital requirements for Corporates, a requirement for credit unions to contribute capital before receiving services, and the basis (share balances or asset size) for the calculation of contributed capital required from members.*

Each of these items was discussed in previous sections of this document. In summary, CenCorp believes risk-based capital is appropriate, contributed capital is required for membership, and either basis for the calculation of contributed capital is sufficient.

3. Permissible Investments.

The NCUA requests comment on limiting permissible investments at Corporates to those that exist for federally-chartered natural-person credit unions (NPCUs). Comments on specific investments examples (CDOs, NIMs, etc.) were also requested.

This section and the one that follows are the most challenging to address. The recent investment losses experienced at Corporates are significantly beyond historical or expected levels. A change is needed, but what should be put in place of existing practice and/or regulation? In the near-term, a greater concentration in agency and or US Treasury securities appears appropriate. These are permissible investments for NPCUs or Corporates today and would not require any regulatory change.

CenCorp has no or limited experience with the specific investment examples cited in the ANPR and doesn't have any comment on them. Considering that Corporates can hold a large share of a NPCUs investable funds, permissible investments should be conservative. The investment authorities of NPCUs would be a good starting point, with investment-grade corporate bonds added. CenCorp believes that new investment options that address some of the shortcomings experienced in the recent market downturn will gain popularity in the future (such as "covered bonds"). The regulation will need to be open to these options as they develop.

4. Credit Risk Management.

The NCUA requests comments on revising the reliance on credit ratings from Nationally Recognized Statistical Rating Organizations (NRSROs). Comments are requested on setting concentration or sector limits and the independent evaluation of credit risk within regulation.

Reliance on NRSROs has been a tenet of financial institution regulation for years. CenCorp concurs with the NCUA's concerns regarding the reliability and value of credit ratings after the events of recent years. Prior to these recent events, the NRSROs have historically done an excellent job of accurately evaluating and identifying credit risk. The NRSROs continue to be viewed as having the most expertise in this area. Changes, such as the parties paying for the analysis, are possible in the future. CenCorp believes that the concept of NRSRO requirements still has some value and should stay in place at this time.

The credit quality of nearly every investment sector outside of US Treasuries was negatively impacted by the economic changes in recent years. This makes the setting of concentration or sector parameters problematic. CenCorp believes that the higher overall capital requirements for Corporates suggested previously will mitigate some of the concentration or sector risks. These risks should be monitored on an individual Corporate basis during the examination process.

5. Asset Liability Management.

The NCUA requests comments on requiring net interest income or spread widening modeling in regulation.

CenCorp sees some benefit in net interest income and spread widening modeling in order to identify trends or potential concerns. This modeling is currently done internally on a regular basis in practice. We believe that this should be evaluated during the examination process.

6. Corporate Governance.

The NCUA requests comments on minimum qualifications, training requirements, term limits, and compensation of Corporate directors. Comments on Corporate Board structure (requiring outside directors or natural-person credit union representation at US Central) and disclosure of executive compensation were also requested.

Similar to NPCUs, CenCorp members determine the individuals to fill the non-compensated director positions. Consideration is given to qualifications of the individuals. Board terms are limited to three years. CenCorp doesn't believe any change in this area is needed.

CenCorp views executive compensation as an employment issue between the Board and management that is already addressed. No change to regulation is needed.

The US Central Board governance has a provision that restricts most director positions to individuals from certain Corporate tiers. CenCorp believes that it would be more straightforward to remove this restriction and have directors determined at large. CenCorp believes that the NPCU perspective that a Corporate receives through NPCU representation on their Board would be valuable at US Central also. We believe NPCUs should also be represented on US Central's Board.

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Conclusion

The experience of recent years point to the need for changes in the Corporate system. These changes are being considered at a time of great uncertainty in the financial markets and in the valuation of investment securities owned by Corporates. All these factors need consideration when planning for the future.

The operations of the NPCU owners are integrated closely with CenCorp. CenCorp's product offerings have been developed to serve the interests of members. CenCorp's business needs to be conducted in a safe and sound manner, while having the authorities/tools needed to generate value on behalf of members. CenCorp believes increases in capital levels and a reduction in term deposits are the most important courses of action going forward.

Thanks again for the opportunity to comment. If you have any questions regarding any of the items above, please contact me at (248) 304-3004 or bwalby@cencorpcu.com.

Sincerely,

W, A Walby

William A. Walby
Chief Executive Officer